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Executive Secretary

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MINUTES
ECONOMIC POLICY COUNCIL

June 17, 1985
4:00 p.m.
Roosevelt Room

Attendees: The President, The Vice President, Messers. Shultz, Weinberger, Block, Baldrige, Herrington, Regan, Sprinkel, Darman, Verstandig, Wright, Lighthizer, Kingon, Porter, McFarlane, Buchanan, Rollins, Speakes, Dawson, Chew, Wigg, Fuller, Whitfield, Khedouri, and Fielding, Ms. Dole and Ms. Chavez.

1. U.S. European Economic Relations

The President began the meeting by noting that Secretary Baker was absent because of problems with his back and that everyone was hoping for a swift recovery. The President called on Secretary Shultz to begin the discussion.

Secretary Shultz said that the subject of U.S.-European trade relations was an important one and deserved being placed in context. Several factors serve as background to sensible thinking on the subject. First, there are a number of reasons for European frustration at this time. The Europeans have suffered and are continuing to suffer from high levels of unemployment. The unemployment rate in most European countries ranges between 12 and 20 percent. This is historically very high and is compounded by the fact that they have had no employment growth for the last 10 years. There is a sense of economic stagnation across much of Europe. This is compounded by concerns on the part of most Europeans about their ability to compete directly with the United States and Japan.

The second element in the environment of U.S.-E.C. trade relations is that world economic conditions are extraordinarily dynamic at this time. Oil prices are declining sharply. It is inconceivable that we could project today what the series of conditions will likely be a year or two from now. In such a dynamic economic environment there is a good deal of unease in Europe.

Secretary Shutlz added that the pace of the U.S. expansion is likely to be lower in the future than it has been during the last two years because we are coming off a very strong recovery. Even if we were able to sustain a healthy long term rate of growth around 4 percent, we will still provide less in the way of stimulus to European economies than we have provided over the past two years.

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Secretary Shultz observed that interest rates are down sharply in the United States in large part because of the significant gains we have made in reducing inflation, and the belief that these gains are reasonably permanent. Secretary Shultz observed that in the United States there are more stable and inviting conditions for investment than in other countries around the world. This accounts in part for the strength of the dollar in international markets. He added that he sees the values of other currencies rising somewhat as their economies recover. This will make U.S. producers more competitive at home as well as in foreign markets and should lead to a decline in the current level of our trade deficit.

Secretary Shultz noted that the Europeans have consistently criticized the United States for the strength of the dollar, and the size of our budget and trade deficits. If the dollar weakens against other currencies, it will make life tougher for the Europeans, but it will likely be for their good. He emphasized that the environment in which we are operating is an extremely dynamic one.

Secretary Shultz described a number of key issues in U.S.-European economic relations. The first concerns agriculture and the heavy European export subsidies that have so dramatically influenced world trade. The European Community's Common Agriculture Policy (CAP) urgently needs reform.

A second key issue on the horizon is steel. Secretary Shultz observed that Secretary Baldrige is spending a great deal of his time on this problem and that we are all hopeful he will make good progress during the coming weeks.

A third major issue concerns European support for a new multilateral trade round. This past week the Brazilians have shifted their postion. Positive results were made with India during Prime Minister Ghandi's visit last week. Secretary Shultz reminded Council members that it was important to have the Europeans on board and that a new round without them could hardly prove meaningful.

A fourth issue on the horizon concerns the enlargement of the European Community. He indicated that the United States has consistently supported the expansion of the European Community to include Portugal and Spain but not at our expense. He indicated he was reasonably confident we could work out a mutually agreeable set of arrangements on the accession of these two countries.

Secretary Shultz observed that the European Commission is undergoing a period of transition with new leadership. He suggested that we will always struggle with the question of the European Commission versus the member states. On trade policy issues the member states often try to hide behind the skirts of the Commission. He suggested that we needed to view trade as an intrinsic part of our bilateral relationships with the member states of the European Community. He urged that we work subtlely with the member states while not undercutting the European Commission.

Secretary Shultz concluded that it is important to coordinate our activities in seeking a new multilateral trade round, in resolving the steel dispute, in ending agricultural export subsidies, in negotiating a new Multifiber Arrangement, and in our treatment of access to technology which concerns the Europeans a great deal.

Secretary Shultz also suggested that we needed to use the new personalities coming on the scene on our side to good advantage. He specifically mentioned William Middendorf, our new Ambassador to the European Commission and Clayton Yeutter, the new U.S. Trade Representative. At the same time, we need to increase contact at the Assistant Secretary level. Secretary Shultz indicated that at the U.N. General Session in New York this fall he would hold a series of bilateral meetings with his European counterparts, and that he wanted to bring in his Cabinet colleagues for several of those discussions.

Secretary Shultz referred to the swelling protectionist sentiment in the Congress and the need to take actions to dispel the notion that the Administration was unwilling to defend our interests in world trade. He added that taking tough action on citrus would help. He observed that the strategy paper prepared by the Office of the U.S. Trade Representative and the Department of State was a good basis for proceeding.

The Council's discussion focused on the unemployment problems facing virtually all European countries, the reliance of Europe on exports to the United States as evidenced by the fact that 40 percent of the real economic growth in Europe in recent years is attributable to European exports to the United States, and the advantages and disadvantages of urging the Europeans and the Japanese to stimulate their domestic economies.

Secretary Block reported briefly on his recent trip to Europe and the European response to our agricultural export enhancement program. He indicated that his European counterparts now understood better our frustration and the political pressures we are facing in the farm community as a result of their candid discussions. He added that the Europeans seem to recognize that the only real winners in a subsidy war are the purchasers.

Ambassador Lighthizer noted that in the late 1970's the United States ran a relatively large $12 billion surplus with the European Economic Community and that today we are running approximately a $12 billion merchandise trade deficit with them. Moreover, the European Economic Community has a fairly protectionist trade policy with far more voluntary restraint agreements than we have in the United States and a greater attraction for managed trade.

The Council also discussed the need to pay more attention to trade in services and the incentives the Europeans provide for their national airline carriers.

2. <u>Section 301 Citrus Case</u>

Ambassador Lighthizer reviewed the Section 301 citrus case which began in 1969 when the European Economic Community raised duties on U.S. citrus products, primarily oranges and lemons, to a level five times as high as the duty imposed on citrus imports from mediterrean countries. The United States domestic citrus industry filed an unfair trade practice case in 1970 and additional cases in 1972 and 1976. For the last 15 years this has been under consideration within the GATT resulting earlier this year in a unanimous GATT panel finding that the Europeans have acted unfairly and the practice should be discontinued.

Throughout this entire period the Europeans have been totally intransigent in their discussions with the United States and unwilling to make any changes or enter into serious negotiations. Because of the way in which the GATT procedures are structured, the Europeans have been able to block implementation of the unanimous GATT panel finding. At stake is approximately $45 million of potential U.S. agricultural exports to the European Community. Ambassador Lighthizer reported that the Economic Policy Council is unanimously recommending to the President that the United States increase the duty on pasta from Europe by approximately 40 percent in retaliation. This would affect approximately $30 million of European exports, significantly below the $45 million level of U.S. products involved.

Ambassador Lighthizer warned that there is a good possibility the Europeans will retaliate and that we may find ourselves in the position of needing to counter retaliate against them.

The Council's discussion focused on the legality of the proposed action, the reason why pasta was selected as the commodity against which to retaliate, the likely European response, and the ability of the United States to reverse the action should the Europeans at some point eliminate their unfair duties.

The Council also discussed having the letter accompanying the decision sent from the Office of the U.S. Trade Representative rather than by the President and selecting an effective date for the imposition of the U.S. action so that it would prevent a flood of European pasta exports to preceed the deadline.

The President approved the Council's unanimous recommendation.

3. <u>Status of the President's Steel Program</u>

Ambassador Lighthizer reviewed the President's Steel Program announced last September to reduce the level of steel imports into the United States from the 26 percent level it had reach in 1984 to approximately 18.5 percent. Since the program was announced, the United States has concluded 14 agreements with steel exporting countries and the agreements now in place should reduce imports to approximately 21 percent of domestic consumption. Depending on certain other factors, we could be well above the projected 18.5 percent target. He explained that there are four principal concerns with the steel program at this time.

The first is our set of agreements with the European Community. The so-called consultation products, which are not covered by the existing arrangement with the European community, have flooded our markets. We have issued an ultimatum to the Europeans that the consultation products issue must be resolved by July 15 or we will take unilateral action. We also must negotiate an extension of the current agreement which is scheduled to expire at the end of 1985.

A second major problem concerns Canada. The President made the decision last December not to negotiate a voluntary restraint agreement with the Canadians. Today the Canadians are approximately 800,000 tons above their share of the market as calculated based on the historical trend. Ambassador Lighthizer recommended that at a variety of levels within the government we communicate to the Canadians our understanding that they would stay within historical levels and of the need to make further efforts to accomplish this. Ambassador Lighthizer did not recommend negotiating a voluntary restraint agreement with the Canadians.

A third problem concerns new suppliers. Seven countries including India, Chile, Norway, Thailand, Trinidad and Tobago and others have suddenly surged in their steel exports to the United States. The seven countries exported 12,000 tons of steel to the United States in 1984 and have already exported in excess of 300,000 tons of steel to the United States this year. One problem in addressing these steel imports is that it takes approximately eight months to file and resolve a countervailing duty or anti-dumping case. Thus, countries are able to export subsidize steel for this period of time without our domestic companies able to defend themselves effectively.

A fourth key issue concerns semifinished steel. Imports of semifinished are running well in excess of the target level of 1.7 million tons. The Council's discussion focused on whether the merchandise trade statistics include goods and services or merely goods, and on the importance of establishing an EPC Working Group on Steel to address the problems outlined by Ambassador Lighthizer.